

AGENDA ITEM 3b
INTERNAL AUDIT SUMMARIES
AS OF SEPTEMBER 30, 2011

Internal Audit Summaries for First Quarter of 2011-12

Review of HIPAA Business Associates

Why Audit Services Did this Review

The primary objective of our review was to evaluate the process for identifying the requirements for business associate agreements and compliance with specific Health Insurance Portability and Accountability Act (HIPAA) requirements for health agreements administered by Health Policy and Planning.

What Audit Services Found

- The Privacy Unit was not able to identify all health related business associate agreements.
- Some agreements did not include the updated business associate boilerplate language.
- The Privacy Unit does not document a review of all agreements covering member Protected Health Information (PHI).

What Audit Services Recommends

- The Privacy Unit should identify all existing business associate agreements and develop a process to track and maintain a complete list.
- The Privacy Unit should ensure that the updated boilerplate language is being incorporated into all new and amended business associate agreements.
- The Privacy Unit should develop a process to document a review of all business associate agreements.

Management's Response and Action Plan to Strengthen Controls

Management concurs and is in the process of implementing the recommendations.

Positive Controls Noted

The Privacy Unit has a policy for business associate agreements. The policy provides the definition of a business associate and outlines that HIPAA requires agreements between California Public Employees' Retirement System (CalPERS) and its business associates that impose safeguards and privacy measures for member PHI. The Privacy Unit identifies HIPAA requirements as changes are made to the regulations. We specifically reviewed HIPAA regulations §164.314, 164.504, 13401, and 13402 to agreement boilerplate language for compliance. The business associate boilerplate language was consistent with the specific HIPAA regulations reviewed. The Privacy Unit developed a tool to assist other divisions in determining which contracts need to include business associate agreement language. This tool was implemented in 2008 in response to a prior audit finding. We also verified with Operations Support Services Division that this tool is in place and being used.

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Securities Lending Policy Compliance Review

Why Audit Services Did this Review

The primary objective of our review was to assess the adequacy of the Securities Lending Program oversight and compliance with Policy guidelines. The detail of the issues noted below is within the Results section of this report.

What Audit Services Found

- Securities Lending Program procedures could be enhanced by addressing policy violation monitoring and the auction process in greater detail.
- Securities Lending Program violation did not include a formal opinion by the General Pension Consultant.

What Audit Services Recommends

- Investment Office should update and expand procedures to address the auction process and Policy violation monitoring.
- Investment Office staff should seek opinions for violations as required by Policy.

Management's Response and Action Plan to Strengthen Controls

Management concurs and has implemented steps to address the audit findings and recommendations. The Office of Audit Services evaluated the corrective actions taken by the Investment Office and validated that management has appropriately resolved the issues identified in the report.

Positive Controls Noted

Overall, the controls over the Securities Lending Program are adequate. Policy exists to govern the Securities Lending Program including lending guidelines. The Securities Lending Program has procedures to guide staff in daily operations addressing areas such as restricted securities, overdraft claim process, internally managed cash collateral, newly funded accounts, internal treasury lending, redistribution of ending income, and corporate action requests. As part of the lending process, the Securities Lending Program conducts auctions for qualified bidders to borrow approved securities. The auction process is a transparent process hosted by a third-party external manager. The Securities Lending Program also obtains reports from external lending agents and borrowers that address loan positions and earnings. Additionally, the compliance monitoring and identification of restricted securities is performed independent of the Securities Lending Program. The Securities Lending Program performs analysis to support decisions made related to restricted securities.

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Business Continuity Management Review

Why Audit Services Did this Review

The primary objectives of this review were to determine whether CalPERS' Business Continuity Program plans and procedures contain sufficient details to enable resumption of essential business functions timely during an emergency, and whether adequate training and testing are conducted to ensure effective and efficient execution of the plans.

What Audit Services Found

CalPERS' Business Continuity Program plans and procedures contain sufficient details to enable resumption of essential business functions during an emergency. However, CalPERS lacks formal written procedures for revising, testing, and approving its Business Continuity Plan. Enterprise Privacy and Protection Office (EPPO) does not verify that divisions and offices conduct regular training, testing and exercise of their Action Plans to ensure that designated staff is familiar with their roles and responsibilities during a continuity event. Also, four of six plans included in CalPERS' Business Continuity Plan lack executive management approval, and California Emergency Management Agency's (Cal EMA) checklist completed by CalPERS contains inaccurate references. Further, parts of the Business Continuity Plan contain incomplete information and require updates. In addition, the building manager does not properly document and retain results of the Lincoln Plaza Complex emergency evacuation drills and the Emergency Response Team's readiness test, as well as the attendees of the Emergency Response and Floor Warden training.

What Audit Services Recommends

EPPO should ensure that CalPERS' Business Continuity Management Program has formal written procedures and verify that effective testing, training and exercise of Division Action Plans occur annually with the appropriate staff to ensure that plans are viable in an emergency situation. EPPO should also ensure that CalPERS' executive management approves the entire Business Continuity Plan and the references listed in CalPERS' Cal EMA checklist are accurate and supported. In addition, EPPO should ensure that the building manager properly documents and retains results of evacuation drills, readiness test and training provided, resolve issues timely, and update the Emergency Plan as necessary.

Management's Response and Action Plan

Management concurs and plans to implement the recommendations.

Positive Controls Noted

The business continuity program staff work with the building manager to ensure that evacuation drills are routinely performed, and that Emergency Response and Floor Warden Teams have been staffed. The drills ensure that CalPERS staff know how to exit the building properly during an emergency. Also, the Emergency Response and Floor Warden Teams provide the necessary assistance to ensure that staff has safely vacated the building.

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Review of Safety Officer Survivor Program

Why Audit Services Did this Review

The primary objective of our review was to evaluate the health plan eligibility determination process and to assess the accuracy of data. Specifically, we focused our review on the health benefit eligibility for the Safety Officer Survivor Program administered within the Customer Account Services Division, Health Account Services.

What Audit Services Found

Health Account Services program oversight over the Safety Officer Survivor Program is generally adequate, but we found some areas where controls could be strengthened to improve program oversight.

- Health Account Services does not consistently determine eligibility and assess whether the death was industrially caused. In addition, Health Account Services does not provide prompt notifications of eligibility determinations.
- Health Account Services interpretation of when the employer notified CalPERS of the death may be inconsistent with the Government Code.
- Case files for the Safety Officer Survivor Program were incomplete and lacked key documents.
- The policies and procedures lacked specific steps to administer the program.
- Internal notification memos to Health Account Services were previously not sent timely.

What Audit Services Recommends

- Health Account Services continue to make eligibility determinations and provide prompt notifications of determinations.
- Health Account Services work with the Legal Office to obtain clarification on notification requirements in Government Code Section 22820(a).
- Health Account Services develop and implement a tracking tool to ensure case files are complete.
- Health Account Services develop detailed policies and procedures to consistently administer the Safety Officer Survivor Program.
- Health Account Services continue to work with Benefit Services Division to ensure timely communication of reported active safety officer deaths.

Management's Response and Action Plan to Strengthen Controls

Management concurs and has implemented steps to address the audit findings and recommendations.

Positive Controls Noted

Health Account Services accurately maintains a complete roster of safety officer survivors. Health Account Services developed an employer statement that is a questionnaire sent to the employer to obtain specific information needed to assess the safety officer death. Examples of the information requested include whether the deceased was an active employee on or after January 1, 2002, as required by Government Code, and a copy of the death certificate.

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Investment Internal Control Framework – Global Equity

Why Audit Services Did this Review

The primary objective of our review was to identify the internal control framework utilized by the Risk Managed Absolute Return Strategy (RMARS), now known as Absolute Return Strategies Program, and Global Externally Managed Equity programs within Global Equity to ensure effective and efficient operations, reliable reporting of investment assets, and adherence to relevant laws, regulations, and policies.

What Audit Services Found

- Documentation clearly demonstrating Board approval and the existence of the CalPERS Hedge Fund Partners LLC structure was not transparent.
- Objectives, authorities, responsibilities, and composition of the Absolute Return Strategy Advisory Board for RMARS are not defined through a charter.
- The wire transfer signature authorization for RMARS and External Equity programs is not specific to the purpose and approval limits per transaction.
- Development or implementation of annual or strategic plan is not required for the RMARS or External Equity programs, nor is the risk management framework transparent within the Global Equity procedures.
- RMARS and External Equity procedures are not current as required by Policy.

What Audit Services Recommends

- Improve transparency and evaluate the necessity of the CalPERS Hedge Fund Partners, LLC.
- Define the authority and role of the Absolute Return Strategy Advisory Board.
- Clarify the purpose and approval limits per transaction for the wire transfer signature list.
- Ensure RMARS and External Equity programs maintain annual and strategic plans, and the risk management process is transparent.
- Ensure RMARS and External Equity procedures are current.

Management's Response and Action Plan to Strengthen Controls

Management concurs with the recommendations and is currently in the process of planning or implementing steps to address the audit findings.

Positive Controls Noted

The RMARS and External Equity Managers program have an established process to review and approve new investments. In addition, new investment decisions for RMARS are presented to the Absolute Return Strategy Advisory Board for review and approval, and meeting agendas, notes, and decisions are retained. In addition, new commitments and investments require opinions from the Legal Office and the Board's consultant to validate the decisions are within the delegated authority of the Global Equity Senior Investment Officer.

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Analysis of Basic Financial Statement Preparation Process

Why Audit Services Did this Review

The primary objective of this review was to evaluate the adequacy and effectiveness of controls over the processes utilized to prepare the financial section of the CalPERS' comprehensive annual financial report (CAFR) timely and accurately.

What Audit Services Found

Controls over the financial statements preparation processes are generally adequate; however, we noted areas requiring increased management oversight to ensure that implemented controls are working as intended. Fiscal Services Division (FCSD) does not always complete monthly reconciliations within 30 days after the month ends. We found instances of delay longer than two months by Retirement Program Accounting (RPA). According to FCSD management, the delay was attributable to redirection of staff to the Pension System Resumption (PSR) project. Our review also revealed that CalPERS staff sometimes completes tasks or provides information later than due dates specified by FCSD financial reporting unit (FRU) staff and financial auditors.

We also found that CalPERS lacks a financial reporting policy defining roles and responsibilities regarding the timeliness, completeness and accuracy of information provided by business partners and program divisions for inclusion in the financial section of the CAFR. In addition, FCSD does not obtain signatures from program division chiefs reviewing draft financial statements.

Some accounting policy and procedures are not current; accounting policy approval signatures are not consistent; and the Long Term Care contract does not specify a delivery due date for the annual data reports required for calculating liability information.

What Audit Services Recommends

FCSD management should increase oversight over monthly reconciliations, provide cross training, and designate appropriate backup persons. FCSD management should also enhance the tracking tools to allow analysis of reasons for delay, establish an escalation process, and formalize its communication to other divisions.

We recommend FCSD management facilitate the development of a financial reporting policy defining roles and responsibilities regarding validation of information received from business partners and program divisions for inclusion in the financial section of CAFR. Also, with the recent organizational structure initiative, FCSD management should seek directives from executive management regarding the authority for approving accounting policies and ensure that all accounting policies are properly approved. In addition, FCSD management should establish a process for periodic review and update of accounting policy and procedures to ensure that they continue to provide clear, adequate, and appropriate guidance to staff.

Finally, we recommend FCSD obtain the signatures of program division chiefs confirming their review of the draft CAFR financial section and coordinate with program divisions to make sure that the contract with Long Term Care third party administrator specifies a due date for the required report.

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Positive Controls Noted

Accounting policies and detailed procedures exist to facilitate accurate and timely financial reporting. On-going monitoring for changes in accounting standards, and assessing impacts in cooperation with program divisions and financial auditors, facilitates timely and effective implementation of new accounting standards. In addition, documentation of accounting risks and controls designed to mitigate identified risks contributes to the overall internal control framework toward the achievement of financial reporting objectives.